Moving in the Wrong Direction

How Have Cuts to Public-Sector Jobs Affected New Jersey's Economy?

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EXECUTIVE SUMMARY

New Jersey's recovery from the Great Recession has been slower than most states and than the nation as a whole, and the gap between our unemployment rate and the rates of other states and the US has grown as a result.

The loss of public-sector jobs in New Jersey has contributed to this prolonged recovery, and eliminated a powerful driver of the state's economy, which kept it alive prior to the recession when increased public jobs compensated for private-sector jobs that were lost.

Unlike the previous two recessions, public-sector jobs continued to be lost after the recession began. This is a marked change in strategy from earlier recessions, when public-sector jobs were maintained or added during and after the downturn to help the state to recover more quickly.

About 61,200 public-sector jobs were lost from the beginning of the recession through the end of 2011, and this total does not count the many private-sector job losses that have been caused by a reduction in the public-sector workforce. And if the monthly employment rate through August continues, this loss in public jobs will be maintained in 2012.

If these public-sector jobs were not lost, New Jersey's 2011 unemployment rate would be more than a full percentage point lower – 8 percent instead of 9.3 percent. That rate would be even lower when accounting for the effect of public-sector job loss on private-sector employment.

Cuts to the public sector make New Jersey a less attractive state for businesses to locate because they want good schools and safe communities. Eliminating public jobs also contributes to the shrinking of New Jersey's middle class and increasing income inequality.

Support to maintain or replace public jobs can be provided in a way that promotes efficiency in government by targeting assistance where it is most needed and establishing performance standards. This support should come from the federal government since New Jersey clearly lacks the financial resources to reverse the trend in public-sector employment.

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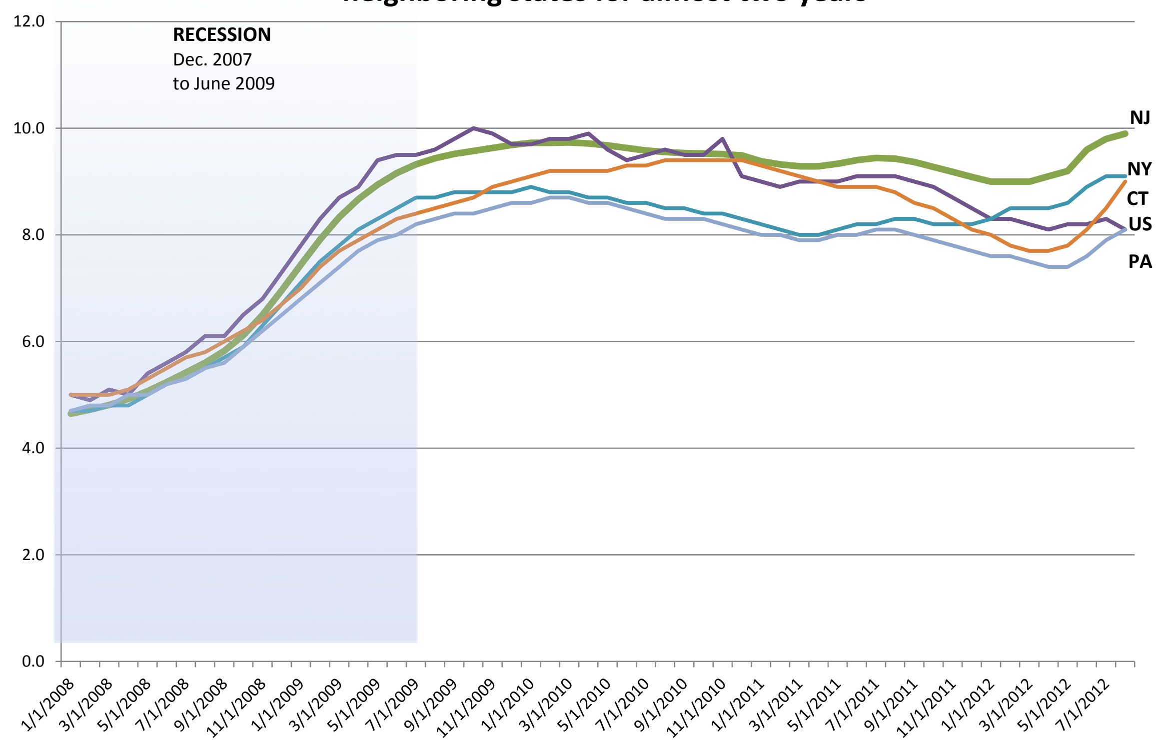
New Jersey's Unemployment Problem

One of the most important measures of a state's economy is its unemployment rate. While the national rate has remained at stubbornly high levels since the Great Recession started in December 2007, rates have varied significantly by state – suggesting that other factors besides the national economy affect a state's unemployment rate. Unfortunately, New Jersey's jobless rate has moved from the middle of the pack to the 4th highest in the nation over the last two years. The double whammy of large numbers of jobless matched with a sluggish rate of job creation is a discouraging combination for the state's future.

New Jersey has a serious unemployment problem. Between 2000 and 2007 (before the recession started), the state's unemployment rate was consistently below the national average except for one year when there was only a slight difference. Throughout the recession, which technically ended July 2009, the state's unemployment rate was below the national rate. But since November 2010, the state's jobless rate has floated noticeably above the national rate and has now returned to its highest level since 1977 (9.9 percent).

NJ's unemployment rate has been above the national average and its neighboring states for almost two years



SOURCE: NJ Department of Labor and Workforce Development and US Bureau of Labor Statistics

It is noteworthy that New Jersey started to fall behind the rest of the country soon after major cuts were made to both state operations and aid to towns and school districts in the 2010 budget. The state not only cut aid for municipalities and school districts, but also imposed a cap of 2 percent on the property tax levy, with only a few exceptions for pension, benefit, and debt payments. The goal was to level out homeowner tax payments by forcing spending cuts. The spending cuts were made. However, in many towns the sharp reductions in tax payments by commercial properties, brought on by higher vacancy rates and reduced commerce, led to homeowners having to fill in the revenue shortfall with property taxes that rose by much more than 2 percent.

The state's unemployment problem got much worse in April 2012 when the state's rate began increasing significantly while the rest of the nation remained mostly flat. By August, New Jersey's unemployment rate was 9.9 percent (compared to a national rate of 8.1 percent), and only Nevada, Rhode Island and California had higher rates. The number of unemployed in New Jersey more than doubled from 208,900 prior to the recession to 454,900. Of course, this number does not include individuals who are involuntarily working part-time or those who have given up looking for work altogether because of the bleak economy.

Monthly jobless reports are notoriously volatile and subject to later re-calculation. While the August estimate of 9.9 percent is preliminary and could change, the *trend* of high unemployment is beyond dispute. The state's rate has been consistently above the national average for 20 months. Even if the August report is later adjusted downward, it is likely that New Jersey's rate will remain near the post-recession high of 9.7 percent in December 2009. In other words, no progress has been made in reducing the jobless rate.

Unfortunately, little progress can be expected unless strong action is taken or the economy suddenly rebounds. Based on a May unemployment rate of 9.2 percent, the Rutgers Economic Advisory Service forecasts that New Jersey's unemployment rate won't even drop to 6 percent until 2020, leaving the rate far higher than the 4.7 percent average for the period prior to the recession (2000-2007)[i]. Given the recent sharp uptick in New Jersey's unemployment rate, the Advisory Service's 2020 projected rate will likely rise in its next published forecast. It is clear that joblessness is a major problem that requires both short- and long-range strategies.

The Rutgers projection is discouraging enough, but it does not take into account the possibility of another national recession that could be caused by the failure of Congress to address the "fiscal cliff," a steep Eurozone recession, or a major terrorist attack. Under these worst-case scenarios, New Jersey is much more vulnerable than other states since it is already performing at a much lower level.

Before addressing what New Jersey can do about this stubborn problem, it helps to understand why New Jersey's unemployment rate is so high in the first place. Clearly, the national economy is the main driver but that does not explain why New Jersey's rate remains so much higher than the rest of the country.

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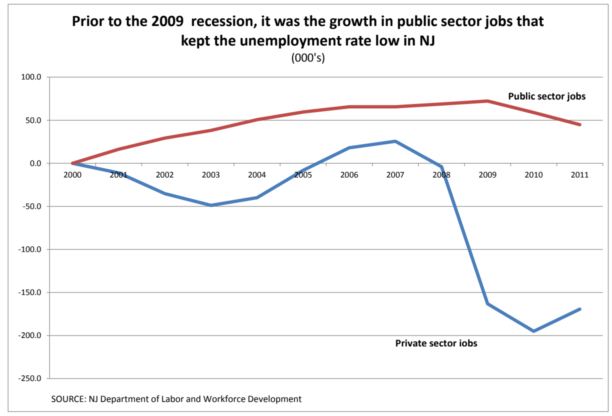
[i] Nancy Mantell, Michael Lahr, *Forecast of July 2012, New Jersey; the Recovery Is Underway*. http://policy.rutgers.edu/reports/recon/forjul12.pdf

The Importance of Public-Sector Jobs to the Economy

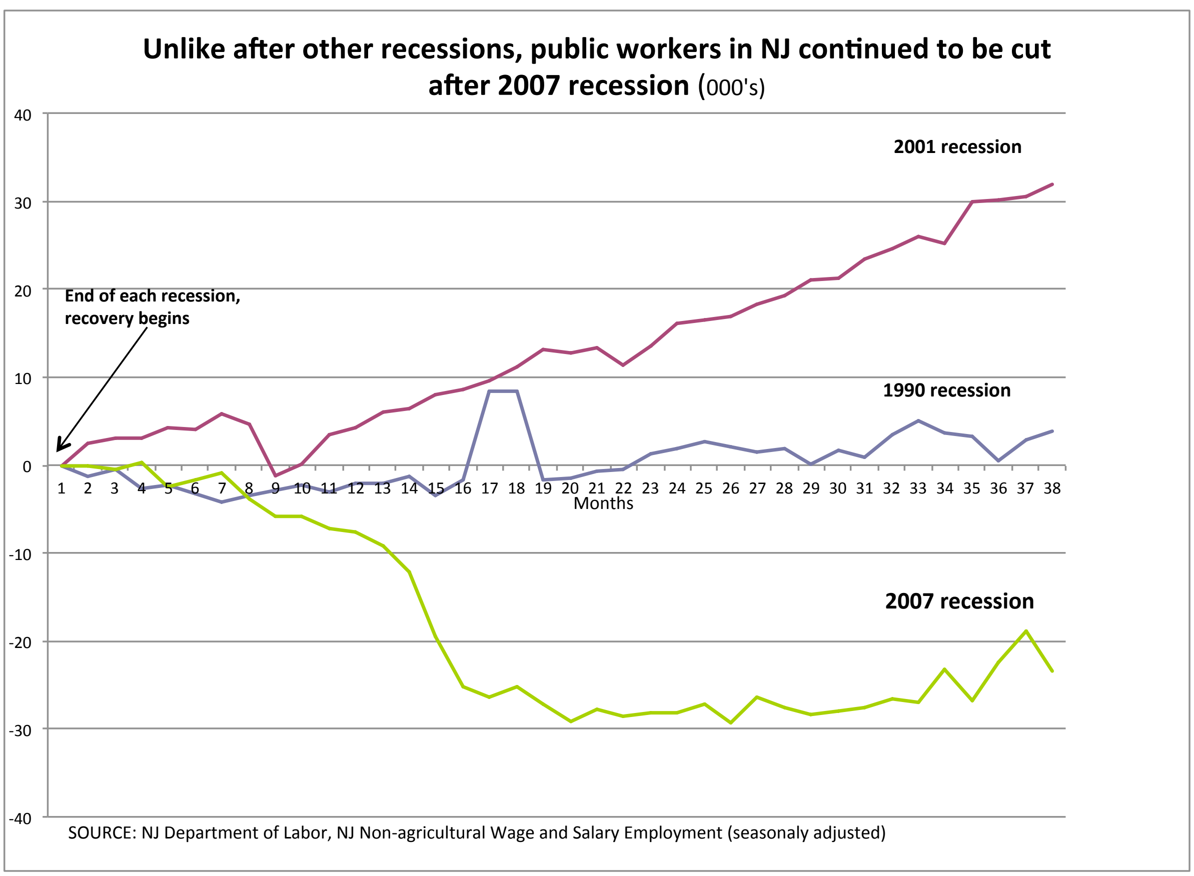
One important piece of the puzzle is the decrease in public-sector jobs. While there was a relatively modest increase in private-sector jobs last year, it was offset by a significant decrease in public-sector jobs.



Prior to the 2009 recession, it was the growth in public sector jobs that kept the unemployment rate low in NJ

The importance of public jobs to New Jersey's economy cannot be underestimated. For most of the last decade, the private sector added few new jobs compared to the public sector. In the years leading up to the recession, 2000-2008, the public sector created over twice as many jobs as the private sector (58,800 vs. 25,500 jobs). Without these increases in the public sector, New Jersey's unemployment rate would have been significantly higher between 2000 and 2005. A downturn is the worst time to eliminate public jobs because the loss of these jobs only exacerbates cuts in private employment.

As the chart below shows, unlike the prior two recessions, public jobs were not restored in New Jersey. In fact, they were cut even further which put the brakes on any recovery.



Unlike after other recessions, public workers in NJ continued to be cut after 2007 recession

Since the beginning of the recession (2007), the number of state and local public-sector jobs has decreased by 20,800 as a result of layoffs and attrition (positions that were permanently eliminated or not filled when an employee retires or leaves)[ii]. This represents, by far, the largest reduction in public jobs since the New Jersey Department of Labor and Workforce Development began keeping records in 1990.

Another method for measuring the full impact of the recession is to compare actual jobs with the number of jobs that would have been developed had the recession not taken place. Based on the normal growth of public-sector jobs between 2000 and the start of the recession, New Jersey would have created an *additional* 40,400 jobs[iii]. Thus, the potential loss of public-sector jobs since the recession began was 61,200 through 2011, as shown in the chart below.

61,200 public jobs have been lost since the recession started, mostly at the local level.*

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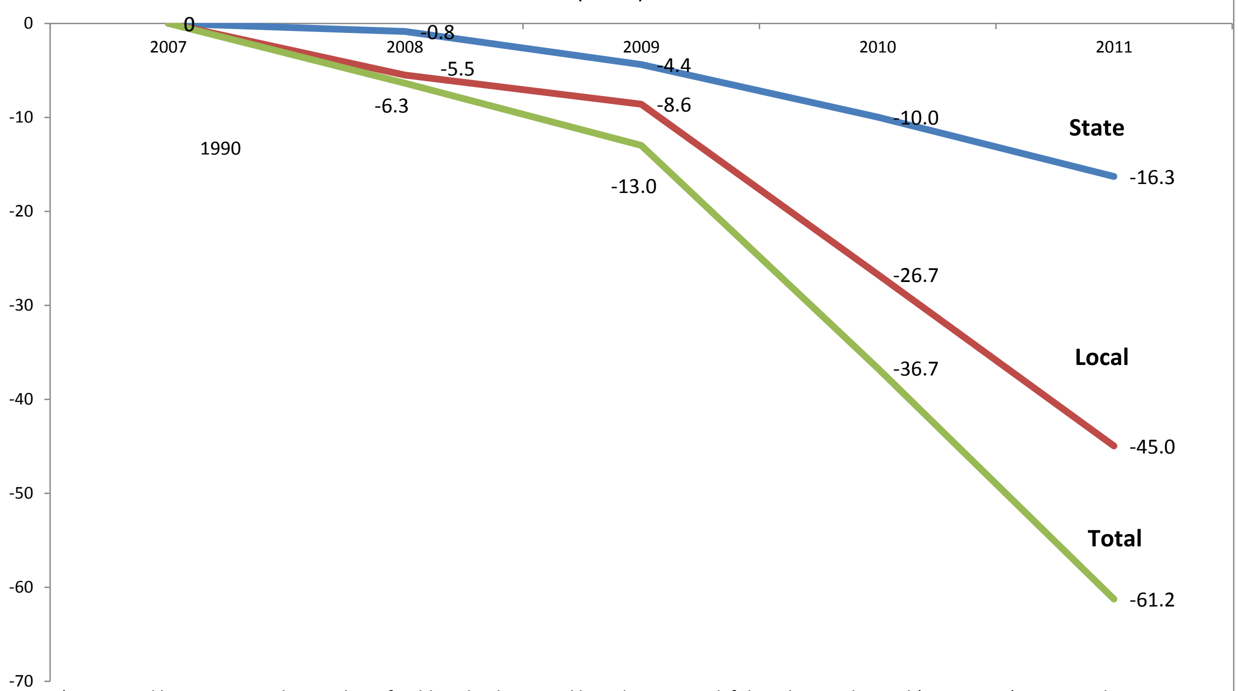


*Computed by estimating the number of public jobs that woud have ben created if the job growth trend (2000-2007) continued compared to the actual decrease in jobs.

SOURCE: NJ Department of Labor, NJ Non-agricultural Wage and Salary Employment (seasonaly adjusted)

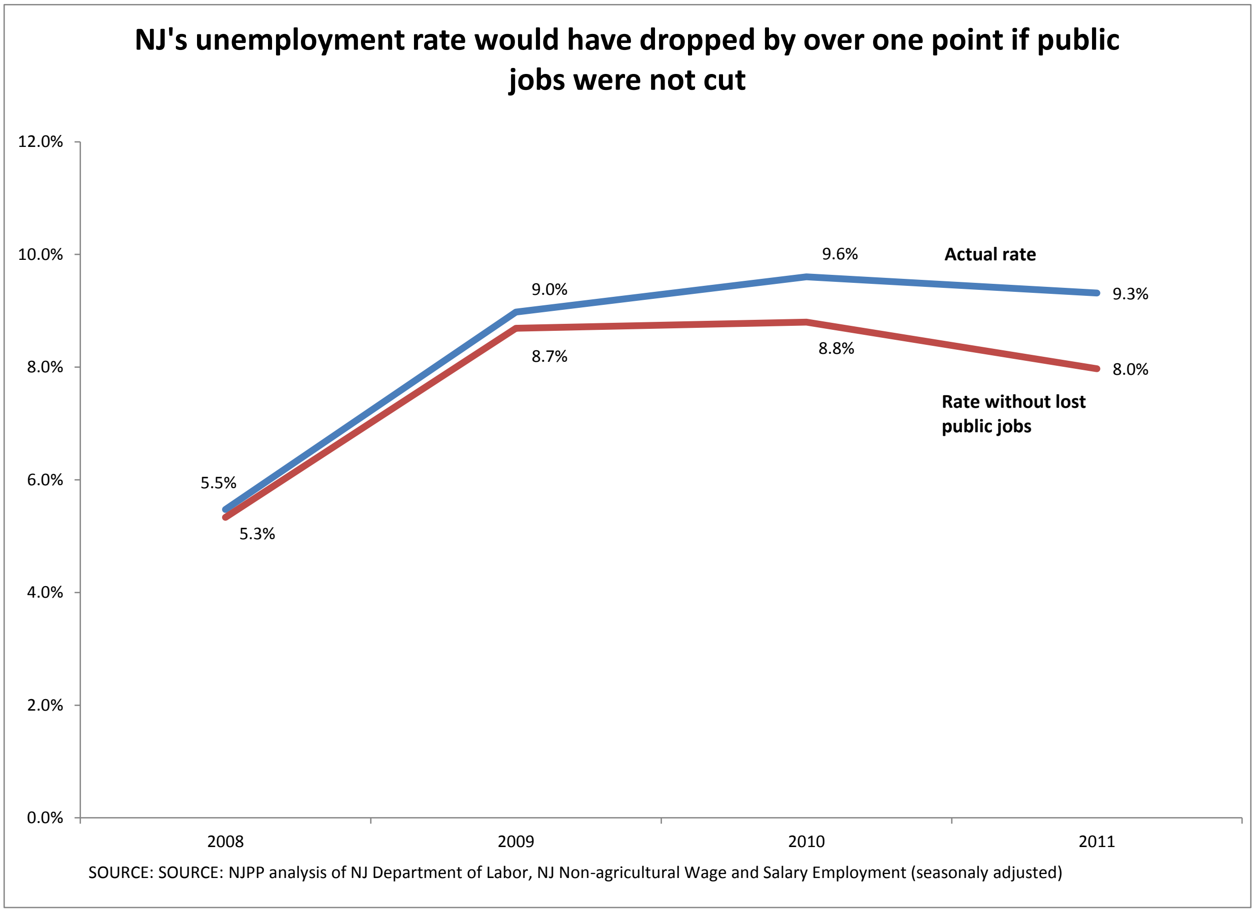
There were more than twice as many lost or "not-created" jobs at the local level compared to the state (45,000 vs. 16,300) although the percentages were about the same. The state positions were lost due to cuts to state services and programs since March 2010 and to attrition of vacated positions not filled. The

[ii] NJ Department of Labor, NJ Non-agricultural Wage and Salary Employment (seasonally adjusted)

[iii] That estimate is on the low side because the prior recession job growth estimate also includes the months during the 2001 recession.

loss at the local level came on the heels of state actions including reduced municipal and school aid and caps on property taxes. Both the state and local levels were also affected by the loss of federal stimulus funds.

As can be seen in the chart below, New Jersey's unemployment rate has stayed stubbornly high, in part due to the reduction and halted growth in public jobs. If New Jersey had retained those 61,200 total jobs, the unemployment rate in 2011 would have been 8 percent instead of 9.3 percent – a 16 percent change.



However, this projected rate of 8 percent does not take into account the multiplier effect of public-sector job loss on private-sector employment.

Public workers need supplies and services that are provided by the private sector. For example, teachers need school supplies; police need uniforms and cars. In addition, the private sector suffers from lower demand for goods and services when public-sector workers retire or are laid off.

At the national level, the Economic Policy Institute estimates that the combination of these two factors alone results in 0.67 private jobs lost for every public job that is lost[iv]. The specific ripple effect that public-sector job losses have on private-sector employment depends on a number of specific contextual factors, such as the *type* of public job being eliminated and the specific state where it's being eliminated, so more analysis needs to be done to know if the multiplier for New Jersey is 0.67, greater, or less. Regardless, it's clear that when including this factor, the 2011 unemployment rate would have been even lower than 8 percent if New Jersey had retained its public-sector jobs.

Furthermore, these rates are on the low side because the formulas for how public-sector job cuts create private-sector *job losses* do not take into account cutbacks in *services*. State and local governments contract with private-sector firms for many services; when these services are cut, private jobs are affected directly. One example is the health care industry, which provides extensive medical assistance funded by the state and localities to vulnerable individuals as well as public employees and retirees.

The private-sector impact is even greater when federal matching funds are involved. Federal dollars have what economists call a "multiplier effect" because they come from outside the state and are circulated throughout the state as new money in the economy. For example, the state cut its support of nursing homes and reduced eligibility for parents in NJ FamilyCare to save $82 million in the FY 2011 Budget. This resulted in a loss of $104 million in federal matching funds. These changes were made permanent, so the loss of federal funds has continued each year since. Using an input-output economic model, every $100 million reduction in state funding results in a loss of 1,742 jobs due to lost federal matching funds[v].

Another example: some counties do not have enough public workers to process food stamp applications in a timely manner. Since food stamps are funded 100 percent by the federal government, New Jersey's economy loses millions of dollars in consumer spending if food stamps aren't efficiently distributed (not to mention the fact that poor families have to also survive with less nutrition). According to Moody's Analytics, each dollar in food stamps generates $1.73 in the local economy.

As was pointed out earlier, this report is based on annual employment rates through 2011 to avoid the fluctuation that is often seen in monthly rates. But it's worth noting that the number of public-sector jobs has increased this year (through August 2012) at about the pre-recession rate. While that is a positive development, in order to recover lost jobs the rate must be *higher* than the pre-recession rate. In other words, unless the pace of job-creation increases further, the total figure of 61,200 lost jobs will remain about the same in 2012.

[iv] Heidi Shierholz, Josh Bivens, *Three Years into Recovery, Just How Much Has State and Local Austerity Hurt Job Growth*, Economic Policy Institute, July 6, 2012 [http://www.epi.org/blog/years-recovery-state-local-austerity-hurt/]

[v] FamiliesUSA Medicaid Calculator [http://www.familiesusa.org/issues/medicaid/calculator/]

Public Services Are Needed to Attract New Businesses

Cuts to state and local jobs can also make New Jersey a less attractive state for business, since they often result in an elimination or reduction in the quality of public services that attract people to New Jersey. One of the most important factors in business location decision is the quality of public services, particularly education. Corporations want to move to areas where there are good public schools and colleges, to ensure that there is an educated workforce to employ and that there are high-quality public schools for their employees' children.

Education is one of New Jersey's most valuable assets in competing for high-value-added jobs. New Jersey public school students rank second in the nation on "the Nation's Report Card," trailing only students in Massachusetts[vi]. Its state colleges and universities are also highly regarded. Public education should be one of the state's biggest selling points in persuading businesses to move to New Jersey.

The recent spate of job losses in pharmaceutical research provides an important example. Despite the drumbeat from the administration, the legislative leadership, and business organizations that New Jersey's high tax rates are the principal explanation for our woes, the Roche and Sanofi-Aventis jobs that recently left New Jersey didn't move to Wyoming or Alabama but to Northern California, New York City, Massachusetts, Switzerland, and Germany. All are known for comparatively high taxes. More importantly, they are known for having the intellectual, institutional and cultural resources to attract highly educated workers.

Unfortunately, the governor's public criticism of teachers and other public employees sends a negative message to businesses considering locating jobs in New Jersey. The same is true for other public services, such as ensuring adequate police and firefighters to provide basic safety.

Reduced morale for public employees also has economic implications. As any manager knows and long-standing research confirms, morale is a crucial factor affecting an organization's productivity. When morale is low and public services deteriorate, businesses and the entire community suffer. Public employees are already under stress due to possible layoffs, reduced salaries and pensions, diminished resources to do their jobs, higher premiums for health coverage and constant pressure to "do more with less." The governor's persistent criticism of public employees reduces morale and productivity, thereby reducing services but without any offsetting financial savings.

The Shrinking Middle Class

Eliminating public jobs contributes to the shrinking of New Jersey's middle class and increasing income inequality. Public jobs are good jobs that pay a livable wage and provide benefits like health insurance and a pension – unlike an increasing number of private jobs. Since the recession began in 2007, New Jersey's inflation-adjusted median household income has decreased by $5,208, from $72,666 to $67,458. During this time, New Jersey has lost 70,665 middle-class households (incomes between

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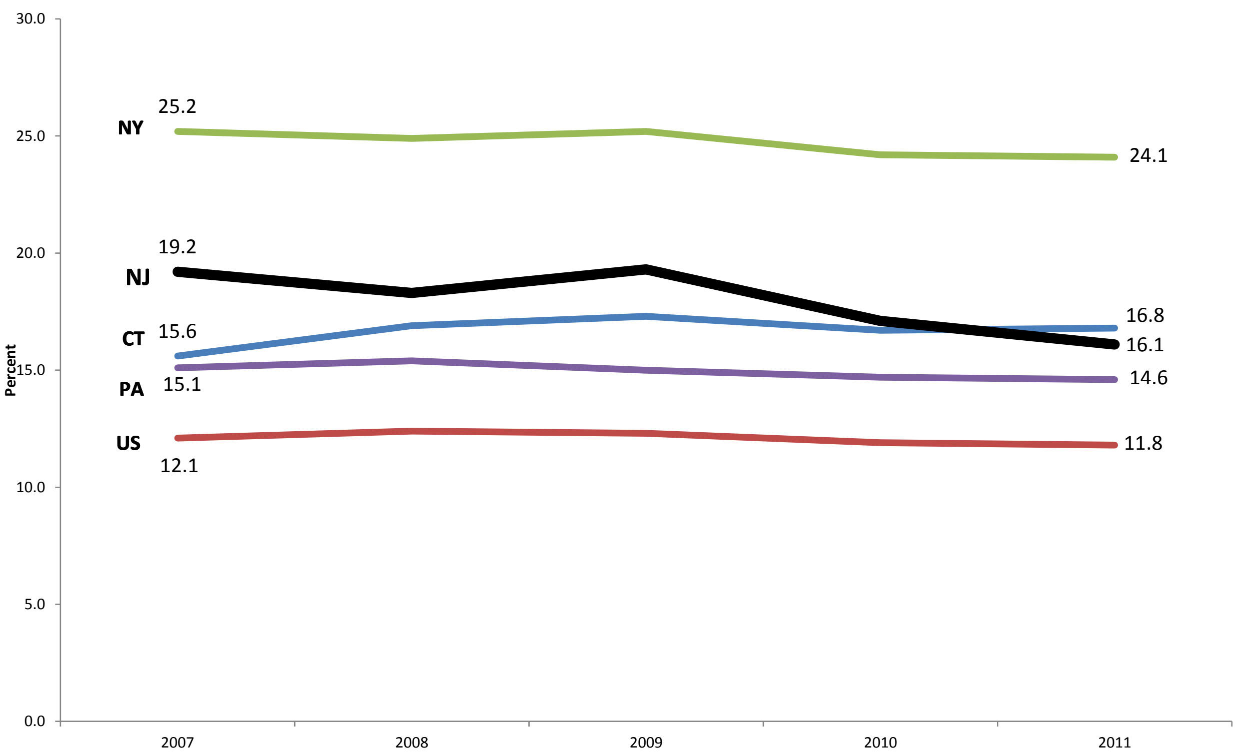
[vi] EPE Research Center, *Report Awards Grades for Education Performance, Policy; Nation Earns a C, Maryland Ranks First for Fourth Straight Year,* January 12, 2012 [http://www.edweek.org/media/qualitycounts2012_release.pdf]

$50,000 and $200,000) while gaining 116,962 low-income households (incomes below $50,000). The percent decrease in the middle class was greater in New Jersey than nationally (3.5 versus 3.1)[vii].

Cuts to public-sector jobs may have also contributed to the rapid decline in union membership in New Jersey. Among all industries in New Jersey, state and local employees are the most highly unionized (31.5 percent versus 43.2 percent, respectively, compared to 6.9 percent in the private sector).

Unions helped grow the middle class by strengthening wages, protecting workers' rights and broadly promoting a shared prosperity. In 2011 union jobs nationally were paid about $938 in weekly usual weekly earnings compared to $729 for non-union workers.[viii] When the recession started, 19.2 percent of all employees in New Jersey were members of unions compared to just 16.1 percent by 2011. That decline represents the largest loss in union membership since the Bureau of Labor Statistics began keeping records in 1989. It is also a much higher rate of decline than that of New Jersey's neighbors (Connecticut, New York and Pennsylvania) and the nation.

Unprecedented drop in percent of union membership in NJ since the recession exceeded U.S and neighboring states



SOURCE: Union affiliation data from the Current Population Survey, BLS.

[vii] 2011 American Community Survey one year estimates, *Selected Economic Characteristics*

[viii] Ann C . Foster, *Differences in Union and Nonunion Earnings in Blue-collar and Service Occupations,* Bureau of Labor Statistics, June 2003.

Incentives for More Efficient Government

Providing support to maintain or replace public jobs *and* reducing unnecessary bureaucracy at the local and state levels need not be contradictory goals. In fact they can complement each other. Just as in the private sector, public services are not always delivered in the most efficient manner. Some have argued, for example, that many of the 566 municipalities in New Jersey should share some services to tame or reduce public costs and property taxes. Efforts to promote greater efficiency in government in New Jersey have been ongoing for decades but usually take on an added urgency when there is a downturn in the economy due to reduced public revenues.

To address this important issue, any efforts to support public-sector jobs should also promote more efficient government. This can be done through a program that provides highly targeted assistance only to those states and localities that meet specific criteria for good government. This could be accomplished in a variety of ways. For example, funding from the federal government to maintain or restore public-sector jobs could be allocated to the state for distribution to localities based on criteria established by the state for efficient local services.

Another approach would be for the federal government to allocate funds directly to localities based on funding specific high-need job categories (such as teachers, firefighters, police, and public assistance workers) that meet minimum standards for each category. It is also possible to combine these two approaches.

Providing federal assistance to state and localities that truly need it and denying it to those who don't sends a powerful statement that the national goal is better government and more accountability.

Conclusions and Recommendations

New Jersey lacks a coherent or effective strategy for restoring the state's prosperity. The reduction in public-sector jobs and services has created a ripple effect that is harming the state's economy and adding to its higher-than-average unemployment rate. An economic downturn is the wrong time to be cutting public services because it only further depresses the economy. Even when times were good, New Jersey relied on growing public jobs to stimulate the economy.

New Jersey clearly lacks the financial resources to reverse the trend in public-sector employment. It is not realistic to propose full restoration via state funding of the municipal and school aid that prevailed before the recession, sustaining public job growth that reflected population increases and met documented needs.

Separating the public from the private sector when talking about New Jersey's economy is misleading – they both affect each other. An economic development strategy that relies only on the private sector while creating major reductions in the public sector is like driving a car with one foot on the accelerator and the other on the brake – you aren't moving forward.

The following is recommended to address this economic emergency:

1. The federal government should provide targeted financial assistance to state and local governments that meet specific criteria promoting efficiency in public services.

Federal funding should be provided over several years to give states time to recover from the economic downturn, which has lasted longer than expected. States should be required to match federal funds at increasing proportions as the recovery proceeds.

To limit the federal cost and promote efficiency in public services, funding should be targeted to states and localities that can demonstrate that there is a need for public jobs based on national or state standards. Priority should be placed on maintaining and restoring public jobs which provide services that are critical for economic development as well as those that provide assistance to the poor and struggling low-income families hit hardest by the recession.

2. The state should take employment effects into account when considering and proposing budget cuts.

Before any budget cuts or other funding constraints are imposed, there first should be an analysis of their impact on public- and private-sector jobs. This is especially important in cuts that result in reduced federal funds, which have a multiplier effect on the state's economy. Policymakers and the public should recognize that jobs lost through attrition are still jobs lost. The negative economic impact is just as great as a job lost through layoffs.

3. The governor and the legislature should pursue joint public-private investment strategies.

This new approach was emphasized in the law reorganizing the health sciences at public universities, which should result in increased private investment around centers of public research. This is a good first step, but businesses not only want good colleges, they also want good public schools and roads as well as safe communities. That will not happen as long as New Jersey continues to pit public employees against private employees. New Jersey's future prosperity depends on balanced, nonpartisan policies that are based on a shared vision of economic goals that recognize the importance of all workers.